

## Chapter III Routes of Pipelines and Emerging Regional Relations in the Caspian Sea Region

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# Chapter III

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### *1. Transport Corridors and Routes*

One of the ways to interpret the phenomena of the “Caspian Sea Region” is to take the view that there “already exists a kind of outline for a new Silk Road running through the Caucasus and beyond the Caspian” and “oil and gas pipelines, roads, railways and fiber optics can make this 21st century Silk Road a superhighway linking Europe and Central Asia.”<sup>1</sup> Many experts in Europe and Asia consider that the best way to study the Caspian Sea region (one of the main sources of hydrocarbons in the next century) is to base the analysis on two notions: a “corridor” and a “route.”

A corridor may be defined as a system of geopolitical, economic, cultural and other interests which is reflected on the map as a series of global or regional links that have their basis in traditions of trade, cultural co-influence, ethnic links, etc. Some examples may be mentioned: Trans-Atlantic (Western Europe – Northern America), Pan-American (Northern – Southern America), Ibero-American corridors, and again the Silk Road from China to Europe. The Silk Road is probably both a concrete historic geographical “route” and a “corridor” that is a system of geopolitical constructions with virtual walls, ladders, steps, etc.

A route is a particular direction in a geographical sense. It is a line on the map. And in relation to oil and gas transportation, it is a pipeline, or tanker maritime transport line, railway or road.

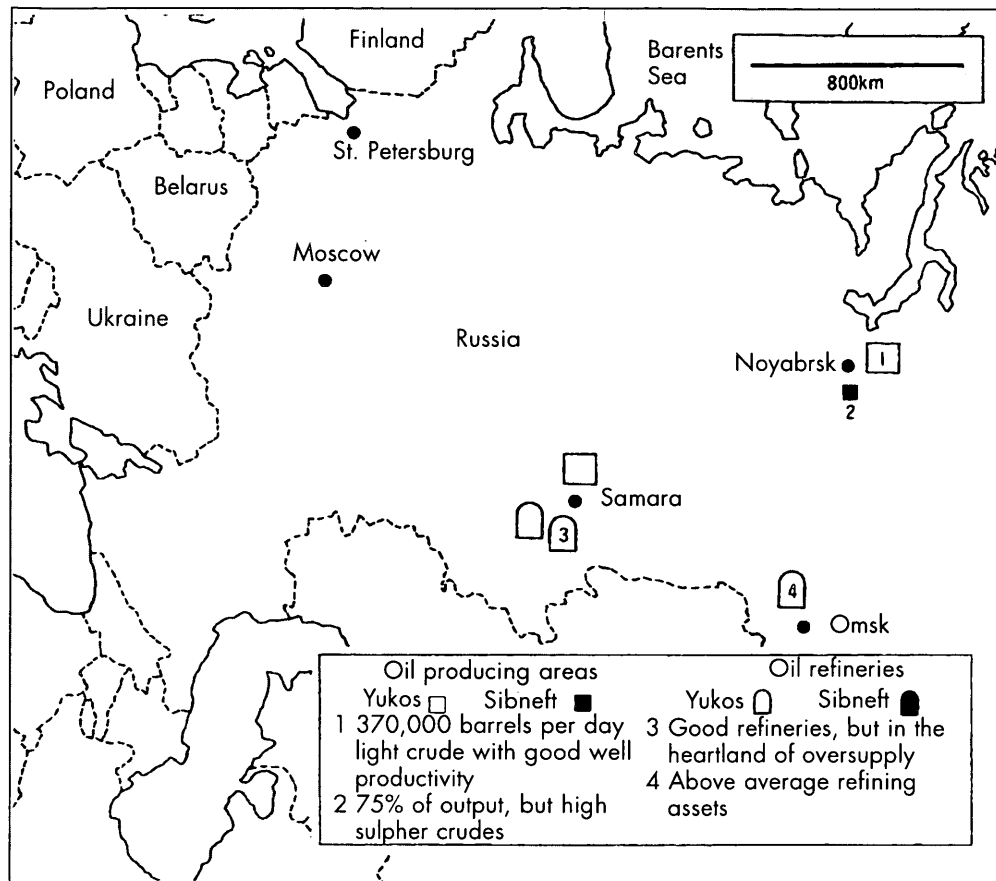
During the Soviet era, Central Asia and the Caucasus “were cut off from their natural neighbours by the longest and most closed border in the world.”<sup>2</sup> The result is that the inherited infrastructure of roads, airlines, telecommunications, as well as production infrastructures are now in a very bad condition, and function poorly. Internal links within the region and external links with other regions are poorly developed. This leads to the conclusion that the Caspian Sea region in the 20th century was cut off from the global economic and political systems in an unnatural manner. A traditional Eurasian con-

text of internal processes has been destroyed and replaced by an artificial imposition of a Soviet understanding of the functional role of this region within the USSR and the “Socialist World.”

The process of the comprehensive exploration, development, production and refining of oil and gas resources in the Caspian Sea region, and optimisation of their transportation and local consumption are only in their initial stage. While on one hand, the Caspian countries still cannot agree on the legal status of the Caspian Sea, on the other hand, the institutionalisation of economic processes is well underway: establishing joint ventures; concerns, corporations, etc.

“The existing pipelines in the Caspian region were designed to link the Soviet Union internally, and were routed through Russia. While the Caspian Sea countries are linked by pipelines to each other, there is still only one crude oil main export pipeline ... Atrau-Samara pipeline ... that connects the Caspian Sea oil production to the Russian crude oil export pipeline system and world markets. Russia has commercial and political interests in continuing to be the major transshipment point for the Caspian’s energy resources. For this to happen, Russia must address commercial concerns regarding reliability, security, competitive tariffs and access. While Russia has existing pipelines that are underutilized, these pipelines do not have the capacity to absorb all the oil and gas the Caspian region could produce. An additional limitation is that the majority of existing oil export pipelines terminate at the Russian Black Sea port of Novorossiysk, requiring tankers to transit the crowded and ecologically and politically sensitive Bosphorus in order to get to the Mediterranean and world market.”<sup>3</sup>

The directions to be chosen for oil and gas transportation from the Caspian Sea region (via Russia; Georgia and Turkey; Georgia and Ukraine or Romania; Iran; Afghanistan and Pakistan; China, etc.) depend on a number of factors. Among them the following should be mentioned:



Source: *Financial Times*, Jan. 20, 1998

### (1) The geographical location of the main consumers and the easiest natural transportation routes

The calculations show that one of the best places to send the forthcoming oil and gas from the Caspian would be through the Mediterranean to the European market, "as oil demand over the next 10-15 years in Europe is expected to grow by little more than 1 million barrels per day." However, there are even more promising regions – "oil exports eastwards could serve Asian markets, where demand for oil is expected to grow by 10 million barrels per day over the next 10-15 years."<sup>4</sup> That's why one can mention two main possible directions of exports: to Western Europe and to East and Southeast Asia.

### (2) Existing physical infrastructures

For example, concerning the Caspian oil, Russia is insisting that "the primary route should be through already existing pipelines and pumping

facilities in Russia."<sup>5</sup> Iran is using similar arguments in support of its own role as a transit country for Caspian oil.

### (3) Geopolitical considerations of the major world powers

The European Union openly declares that the Western countries' aims are: "to support the political and economic independence" of the Central Asian and Transcaucasian countries; "to encourage further regional cooperation" among these republics; and to assist them in "the diversification of the traditional Moscow-centred trade."<sup>6</sup> Similar aims are expressed by the US, sometimes with a more precise objective to diminish the role of Russia in the region. Russia will also probably realise the inevitability of the diversification of transportation routes, and will avoid resisting natural processes and try to accommodate its own strategic interests to the economic and political megatrends of the world.

**(4) Local security problems.**

In the Caspian Sea regions and the adjacent areas these problems are represented by the conflicts between Armenia and Azerbaijan, instability in Georgia and Chechnya, tensions in Turkish Kurdistan etc.

**(5) Availability of local legislation favourable to business, good system of tariffs and taxation, efficient government.**

Of course, efficiency does not necessarily mean democracy. Even though there is a lot of rhetoric in the West concerning its objective of supporting democracy in the new independent states,<sup>7</sup> financial interests lead "the companies in some cases to support more authoritarian regimes in order to guarantee their investments."<sup>8</sup>

Some of the possible future routes are competing projects (i.e. either one or another would be constructed and be operational); some can supplement each other.

## **2. *The Major Actors in Gas- and Oil-related Politics in the Caspian Sea Region***

Decision-making processes (at different levels) concerning oil and gas exploration, extraction and transportation in the Caspian Sea region are similar to those in any other sphere of the world economy and politics. These processes include:

- (1) A comparative analysis of global energy reserves and the related economic and political issues. Such analysis shows that proven oil reserves in the Caspian Sea region constitute "about 15% of the known global resources of oil and gas,"<sup>9</sup> valued at some US \$ 4 trillion at today's prices,<sup>10</sup> and "it will be a critical piece of the global supply of energy over the next 30 to 40 years."<sup>11</sup>
- (2) The elaboration of a sound strategy and possible tactical steps.
- (3) Pilot research and development projects and preparatory action in the adjacent substantive areas.
- (4) The legitimisation of development projects (finding financial resources, signing and ratifying agreements, contracts etc.)
- (5) The institutionalisation and implementation of

development projects (which includes many different types of activities ranging from guaranteeing physical security to providing a financial and ideological basis for the projects' future.)

The institutional nature of the actors involved in the decision-making process in oil and gas exploration, extraction and transportation differ: there may be states (as a sovereign national authority) and their coalitions, state bodies, QUANGOs (quasi-non-governmental organisations), powerful lobby groups (representing ethnic, religious and other cultural and socio-political entities) in the state institutions, financial centres, companies, research centres, and non-governmental political institutions (formal and informal). For example, the latter may include political parties, trade-unions, workers collectives, clans, even families (because profitable businesses – which oil and gas actually are – quite often become a "ruling family" affair not only in the "Third World," but in post-communist countries as well.)

The above-mentioned analytical functions are usually performed by the major oil and gas companies, specialised research institutions and universities (for instance, Dundee University in Scotland), state organisations – permanent, such as the US Department of Energy (its Energy Information Administration), or "ad hoc" – such as (in the US) an inter-agency working group for Caspian Energy, chaired by the National Security Council.<sup>12</sup> Often local actors in the decision-making process in the new independent states are unable to perform these functions without external assistance (due to the lack of adequate analytical staff, information, funds, proper organisational schemes etc.)

Activities within pilot projects, and preparatory actions in the adjacent substantive areas are often undertaken by some minor actors contracted by the major players in the "global game" in oil and gas markets, or even by actors from almost totally different spheres of activities. An interesting example of performing such functions within a far-reaching strategy (of a business community and state), is the following: in 1992 with the assistance of British Petroleum, a plane was chartered and Azerbaijani children were taken to Aberdeen – the centre of the British oil industry. "The message was clear: the British were investing in Azerbaijan even

though there would not be a sniff of oil for at least five years.”<sup>13</sup>

The legitimisation of development projects may be achieved at different levels and in various forms. Usually major financial centres use companies to achieve their goals, and involve the governments in a “Great Game.” Other actors as a rule play a minor role, but sometimes in some places these “smaller” actors can acquire a decisive role. The examples may range from (a) Chechnya’s fight for independence and Chechen threats of terrorist attacks on sensitive Russian (and other countries) energy sites, and (b) other Russian regions (e.g. Tatarstan) having considerable scope of autonomy in administering their natural resources, to (c) particular personal preferences of top state and companies’ administrators in choosing their business partners (sometimes in semi-legal or even illegal off-shore arrangements).

Russia’s recent experience in privatising oil companies and investing in Caspian projects provides a most vivid examples of the struggles and compromises between the major local and international financial groups.

There are four main types of arrangements concerning the creation of the legal basis for huge investments into the oil and gas production sectors of national economies of the Caspian countries.

(1) Arrangements at a **“pure” government-to-government level**. A good example is the “Action Program on Economic Partnership” of the United States and Kazakhstan (November, 1997), a plan to encourage far larger American investments in Kazakhstan, especially in developing its energy resources. This is a solid basis for the US\$1.4 billion in investments which have been made by US companies in Kazakhstan (accounting for 40% of foreign direct investments in this country), and over US\$20 billion in the future in the form of investments of US oil and gas companies in developing Kazakhstan’s oil and gas industry.<sup>14</sup>

(2) Arrangements at a **government-to-government level which are preceded by the decisions taken at a government-to-company level**. This case is exemplified by the US\$9 billion agreement between the Kazakhstan and Chinese governments on shipping oil from Kazakhstan oil fields to China. This agreement was signed after the May 1997 tender to develop the Uzen and Aktyubinsk

hydrocarbon fields (in western Kazakhstan) was won by the China National Oil Corporation. According to the terms of agreement, about 3,000 kilometers of pipeline will be built from Aktyubinsk to the Chinese border in 60 months. Crude oil shipments will amount for 20 million tons annually. The political weight of this contract was stressed by the Chinese Communist Party Politburo member Li Peng who called the deal a “new page in Kazakh-Chinese relations,” and by Kazakhstan President Nursultan Nazarbayev who called it the “contract of the century.”<sup>15</sup>

(3) Arrangements at a **government-to-company relations level** involving the use of the existing legal framework or the passage of special legislation or by-laws. One of the largest projects in the Caspian Sea region – the creation of the Tengizchevroil 50/50 joint venture<sup>16</sup> between Chevron and Kazakhstan – represents this “pure type” of **company-to-government level arrangement**.

In Azerbaijan on 4 February, 1994, President Heidar Aliyev passed the Decree “On the Acceleration of the Development of Offshore Oil and Gas Fields in Azerbaijan.” Then on 20 September, 1994, a exploration, development and production sharing agreement between the national oil company, SOCAR, and transnational oil companies was signed – another “Contract of the Century” – valid for 30 years and entitling Azerbaijan to 80% of the extracted raw oil. And at last on 12 December, 1994 this agreement was ratified by the Azerbaijani Parliament, Milli Mejlis.<sup>17</sup>

It is worth remembering that sometimes the role of the national government in the above-mentioned arrangements may be replaced by the government of a subnational level (e.g. by the Republics or even Oblasts within Russia). Other post-Soviet countries with autonomous regions (Republics) – Uzbekistan, Georgia, Azerbaijan, Ukraine – may have some legal and organisational problems in deciding who will have jurisdiction over specific contracts related to the use and transportation of natural resources.

(4) Arrangements at a **company-to-company level** which do not require special ratification by the government, e.g.: particular contracts between the national (state) oil or gas companies, or private local companies and foreign companies to create a joint venture or to start a joint project.

Sometimes the main players in the oil and gas "Great Game" in the Caspian region seem to be private companies, but the real authors and referees in this game are usually financial centres and governments. This type of arrangement may be characterised as a **company-to-company level of decision-making under government control or guidance.**

The institutionalisation and implementation of development projects may be performed by any of the above-mentioned types of actors. In the same way obstacles to oil and gas development projects can also be created by different types of actors: (a) the states which impose some form of sanctions (like the US vis-à-vis the involvement of Iranian companies) or undertake certain other kinds of limiting actions; (b) financial groups and companies waging commercial and political "wars" against one another; (c) ethnic and religious lobby groups in the decision-making bodies of the major states, and other types of competing factions in the state institutions; (c) gangs "drilling holes in the pipeline"<sup>18</sup> and terrorists, local "mafias" comprising the bosses of criminal businesses and corrupt state bureaucrats controlling sections of pipelines and other transportation facilities etc.

Usually there are coalitions of various actors supporting or opposing particular oil and gas development and transportation projects. These coalitions may be very unusual, as in other spheres of post-Soviet politics and economy. For example, in 1992, Eduard Shevardnadze came to power in Georgia as a result of a coalition between the local former Soviet "nomenklatura," gangsters organised into an army, and Russia.

In 1992-1994, the Armenian-American lobby in the US played a key role in restraining active US involvement in Azerbaijani oil development projects. Section 907 of the Freedom Support Act of 1992 proscribed "US Government interaction with the Government of Azerbaijan due to the latter's maintenance of an economic blockade of Armenia,"<sup>19</sup> and precluded "any direct US Government humanitarian assistance to the former Soviet Republic of Azerbaijan."<sup>20</sup> Nevertheless, "pure economic" and strategic interests gradually overweighed the pressure of the Armenian lobby. Significant adjustments took place in the US policy related to Armenia and Azerbaijan. Meanwhile in 1995 US President Clinton "encouraged Baku's continued progress toward structural economic and political reform,"<sup>21</sup> in

the influential American press, the Armenian Government of Levon Ter-Petrossian became an object of sharp criticism for its "increasingly authoritarian and despotic regime,"<sup>22</sup> and the Armenian-American lobby started to be stigmatised for "poisoning the promising business environment for American firms."<sup>23</sup> Quite soon many contracts began to be signed between American companies and their Azerbaijani counterparts; in 1997, the President of Azerbaijan H. Aliyev visited the US.

It is obvious that the reasons for such changes in attitudes lie not only in the sphere of oil and gas economic interests, but also in the fact that Armenia has become a strategic ally of Russia. It "has signed a twenty five-year military basing agreement with Russia and has effectively ceded control of its borders to Russian forces."<sup>24</sup> Meanwhile Azerbaijan is assessed as a "Western-oriented, secular Muslim" state<sup>25</sup> that "has aligned itself with America's interests" and is its "natural partner in the region."<sup>26</sup> A strong Russia is again deemed as a threat to US strategic interests. The latter presuppose "avoiding the de facto or de jure reconstitution of a southern-tier Soviet Union,"<sup>27</sup> and also by the US using "every effort to finding the means to bring the oil and gas resources of the Caspian Sea Basin to market through routes that will not enrich the Iranians, or for that matter, the Russians or Chinese, and that are not subject to possible coercive manipulation by such powers."<sup>28</sup>

**Arrangements to develop oil and gas fields, and to construct and maintain the routes of oil and gas transportation may be: (a) confrontational; (b) consensual; (c) mixed.**

An example of an attempt to create a consensual arrangement is that of the Azerbaijani government to attract Russian and Iranian companies to the Azerbaijani oil projects in the Caspian Sea. President H. Aliyev does not want to be oriented only towards the US, and favours a balanced foreign policy.

Attempts to isolate a competitor (especially if it is a big country) or to eliminate its influence can easily become counterproductive. On a company and political and economic clan level, this is demonstrated by the creation of a very active anti-presidential opposition in Ukraine in 1997 after the measures taken by the government against the

company "United Energy Systems of Ukraine," which was closely connected to ex-prime-minister Pavlo Lazarenko.

On an international inter-state and state-multinational corporation level, the generally counterproductive effects of some attempts to marginalise Russia in the Caspian regions may quickly encounter an asymmetric (judging by the resources involved) response potentially destructive to the stability of regional security. In February 1998 after the voluntary resignation of Armenian President Levon Ter-Petrossian and a terrorist attempt to assassinate Georgia's President Eduard Shevardnadze, there were some anti-Russian publications linking these events to alleged covert Russian activities aimed at destabilising the Transcaucasian area in order to influence the decisions concerning the routes of the oil and gas pipelines, and to turn these routes into Russia.<sup>29</sup> Even though such publications are likely to contain false conclusions and to be exaggerated, in fact the main conclusions which may be drawn from them are the necessity of balanced decisions and the fragility of the existing political and economic arrangements in the majority of post-Soviet societies.

The specific types of individual local states may be analysed according to different criteria.<sup>30</sup> In particular, with regard to the role of the respective countries in the extraction, transportation, refining and final consumption of hydrocarbons, the analysis of the states of the Caspian Sea and the adjacent regions should be based on the concept of such "pure types" as: (a) producers; (b) transit routes providers; and (c) consumers, and the identification of specific "mixed types" which exist in present day reality. Meanwhile "taking the availability of energy resources as a standard," these states "fall into three categories: (1) states with a positive balance of energy reserves: the Russian Federation, Kazakhstan and Turkmenistan; (2) states which can partially provide their own fuel: Azerbaijan, ..., Kyrgyzstan, Tajikistan and Uzbekistan; (3) states possessing no reserves or less than 5-10% of their fuel requirement: ... Georgia and Armenia."<sup>31</sup> When judging by the level of corruption in the government, "on a spectrum of oil countries with Norway at one end and Nigeria at the other," some of the post-Soviet states are "getting quite close to the wrong end."<sup>32</sup>

Analysing the comparative weight of the states and other actors in decision-making in the Caspian Sea region, it seems that quite often the local states

are not the main players in the global energy game even in their own region.

### 3. *Conclusions*

- (1) The current natural processes of change in the global structure of production and services, and further regionalisation are clearly reflected in the economic and political life of the post-Soviet countries of the Caspian Sea region. The formerly solid, centrally planned economic and social organism of the Soviet Union is now split into several areas, each with their own scenarios for integration into the world and regional economies.

Most of the former Soviet republics are seeking to diversify their economic and political ties and to secure their own place in the international economy and political system, and to work to reject Russia's attempts to impose policy decisions.

- (2) Since the collapse of the USSR, there has been a significant change in the position of the main actors in the oil and gas market of the former Soviet republics, and in the Caspian Sea region in particular. Strong positions are now held not only by Russian companies and state institutions, but more and more by American, British and other Western companies. The US has openly declared the Caspian Sea region as a zone of US strategic interest.

Taking into account the necessities of the global oil and gas markets and the shifts in the importance of various regional markets, a more active policy by East Asian countries is expected in the Caspian Sea region.

- (3) The re-organisation and re-shaping of the CIS is taking various forms: (a) some of the former Soviet republics are seeking greater integration with one another, and their new institutionalised regional organisations (playing the role of customs unions, free trade zones, etc.) may soon be more economically and politically important (for themselves) than the CIS itself (or its possible future substitute), e.g. the Union of Byelarus and Russia, or the Union of Four (Byelarus, Russia, Kazakhstan and Kyrgyzstan); (b) some of the present-day CIS

members may try to conduct a policy of actively distancing themselves from the CIS and Russia (somewhat similar to the policy of Baltic states). A kind of a set of "mixed" arrangements, comprising elements of both of the above-mentioned types of policies can also be envisaged, e.g. within the logic of creating a strong Central Asian Union.

- (4) There are serious policy-making problems for many post-Soviet countries in relation to the strategically important issues of extraction and transportation of oil and gas: (a) a lack of a generally coherent state policy; (b) the narrow egoism of the positions of the state agencies and commercially operated quasi-non-governmental (QUANGO) bodies (e.g. Gazprom) vis-à-vis their own countries in general and the interest of the international regional (post-Soviet) community; (c) the lack of proper coordination of the policies of different post-Soviet (CIS) states (Russia, Ukraine, Kazakhstan, Turkmenistan etc.); (d) widespread corruption.
- (5) The future development of the systems for oil and gas exploration and transportation in the Caspian Sea region will take place in a number of different ways. A lot will depend on the evolution of the ruling elites in each of the post-Soviet countries of this region. One must be ready to see serious repercussions for the whole area due to possible (and quite predictable) personal, "clan" and "social class-oriented" changes in the higher levels of the state hierarchies in Russia and to some extent in Ukraine (the two countries which seem to be the most vulnerable to public discontent). A possible (and in some countries historically inevitable) transition from the current "comprador" (i.e. corrupt bureaucratic-capitalist) model of development to a national-capitalist one should be taken into account by the major actors in the global market for oil and gas in order to be prepared for some future policy adjustments.
- (6) The creation of a new pluralistic (multi-route) infrastructure of oil and gas transportation from the Caspian Sea region to the main consumer areas (primarily those in Western Eu-

rope and Eastern Asia) may be partially and temporarily blocked, or at least hampered by the specific political decisions of some of the major actors in global politics. In particular, one should remember the real danger that the relative stability of oil and gas prices, and therefore the global energy market in general, will be undermined by the oversupply from the new fully opened producing areas of the Caspian, "liberated" from infrastructural "blockade." The relevant pro-active or reactive actions of the major players in the global political and economic system may vary significantly. Some peculiar ways of averting such danger may presuppose obstructing the creation of an "overly" pluralistic (diverse) system of oil and gas transportation from that region. Other "solutions" may be connected with the freezing of some components of the transportation network and/or the production units (or even areas) through the use of political decisions, including ones aimed at the manipulation of the internal politics of local countries.

It seems that the most efficient and effective (but unfortunately hardly probable, at least at the present time) approach to the issues of oil and gas supply (and therefore their price) would be based on two interconnected pillars: (a) the diversification of transportation infrastructures; and (b) the implementation of responsible politics characterised by the coordination of the short-term and the long-term strategies of the countries of the region, taking into account the interests of the global community of nations in general.

## Notes

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